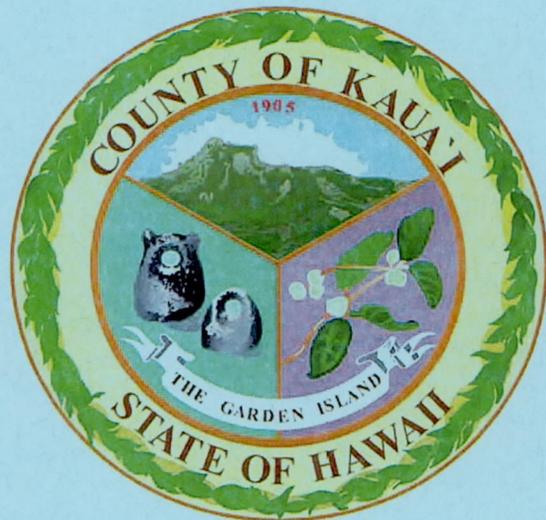


# MANAGEMENT ADVISORY REPORT

County of Kaua'i, Hawai'i



For the Fiscal Year Ended  
June 30, 2013

P-201.1

4/16/2014

C-2014-09

**COUNTY OF KAUA'I**

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To the Chair and Members of the County Council  
County of Kaua'i  
Lihue, Kaua'i, Hawai'i

In planning and performing our audit of the financial statements of the County of Kaua'i, State of Hawaii (the County) as of and for the fiscal year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the County's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

However, during our audit, we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this report summarizes our current findings and recommendations regarding these matters. This letter does not affect our report dated December 12, 2013, on the financial statements of the County.

*N&K CPAs, Inc.*

Honolulu, Hawai'i  
December 12, 2013

## **CURRENT FINDINGS AND RECOMMENDATIONS**

### **13-01 Improve Internal Controls Over the pCard Purchases**

In February 2012, the County started issuing purchase cards (pCard) to several departments and agencies for handling small purchases (less than \$1,500). The procedures for using the pCard did not change the existing procurement procedures. The County's policy requires that any purchase made by the pCard must be preapproved by the respective pCard coordinator and documentation of quotes for purchases over \$500 were still required procedures.

During our audit of 40 pCard transactions during the fiscal year ended June 30, 2013, we noted the following:

- We noted one instance where there was no evidence that the procurement process was followed prior to the purchase being made.
- We noted seven instances where the documentation provided noted that the purchase was verbally preapproved.
- We noted one instance where the approval was done after the purchase was made.
- We noted five instances where there was no evidence that the purchase was approved prior to it being made.

The County currently requires the respective departments and agencies to self-report any procurement violations to the Division of Purchasing. Other than the self-reporting of violations, the County does not have a monitoring control to ensure that the departments and agencies are following the purchasing procedures. However, specific guidance was provided to all departments through the issuances of memorandums, formal policies and procedures, and formal training to department and agency personnel who were involved in the use of pCards.

#### **Recommendation**

The County should strengthen internal controls over the use of the pCard. These include continuous monitoring of pCard transactions to ensure proper procurement procedures are followed; and implementation of violation reports and consequences for departments and agencies not following the established procedures.

## **13-02 Review Treasury Trust Accounts**

The County maintains fiduciary funds that are limited to agency funds. Agency funds are custodial in nature and are used to receive and disburse funds for an entity or individual that is not part of the County. Agency funds function as a clearing account and do not measure results of operations. The County has the following agency funds:

- Trust and Agency Fund
- Treasury Trust Fund
- Real Property Trust Fund

At June 30, 2013, the County had approximately \$1,726,000 in these treasury trust accounts. We reviewed 4 of the 12 treasury trust accounts totaling \$1,670,443, noting the following:

- Public Works Fiscal Treasury Trust - The account holds 40 different deposits for a total of \$144,300 from May 9, 1986 through September 4, 2007. The remaining balance of \$158,450 was from current deposits from 2009 through 2013.

### **Recommendation**

The County should determine the proper disposition of the older balances held in the treasury trust accounts and implement procedures to require timely follow up on aging deposits.

**13-03 Reconcile and Review Residential Refuse Collection Assessments**

The County began assessing the Residential Refuse Collection Assessment (RRCA) on July 1, 2011 and utilizes the real property tax assessment system to account for these fees. The RRCA fees and related receivable are recorded in the Solid Waste Fund and are the responsibility of the Solid Waste Division. The County has generated reports that display the consolidated outstanding balance for the real property taxes and RRCA by customer. However a report to separately account for the RRCA receivable balance at June 30, 2013 was not generated.

The Solid Waste Division is responsible for the RRCA and should periodically review the report to follow up on old and delinquent balances. In addition, the outstanding balance at year end should be reconciled to the revenues and receivables recorded in the Solid Waste Fund. The establishment of procedures to review and reconcile the RRCA account balances will allow the County personnel to properly monitor and account for the RRCA. At June 30, 2013 the RRCA receivable balance was approximately \$139,400.

**Recommendation**

The County should generate a report throughout the year that accounts for RRCA outstanding balances to allow personnel to monitor balances and reconcile outstanding balances that are recorded in the real property tax assessment system to the general ledger.

#### **13-04 Review Unearned Revenues And Grant Receivables**

The County receives Federal and State financial assistance for various projects throughout the year which requires the County to use the funding for a specific purpose. At fiscal year end, expenditures incurred in excess of amounts received are recorded as accounts receivable from the funding source. Any amounts received prior to applicable eligibility requirements being met are recorded as unearned revenues. The County has the following funds which have balances related to this timing difference:

- Federal Grants Fund
- State Grants Fund
- CIP Grants Fund

During our testing of the above funds, we noted grant funds receivable dating from 1998 through 2009, comprising of 15 separate grant balances. In addition, we noted unearned revenue balances dating from 1991 through 2012, comprising of 49 separate grant balances. Amounts outstanding were related to federal and state funding sources and involved nine different County departments.

During our audit of these outstanding balances, we noted that multiple grants had no activity and needed further investigation by each department to determine the status of the related receivable or unearned revenue.

#### **Recommendation**

The County should investigate and determine the proper disposition of balances recorded in both grant funds receivable and unearned revenue in a timely manner to properly account for these grant balances.

**STATUS OF PRIOR YEAR'S RECOMMENDATIONS**

**County of Kaua'i, Hawai'i**  
**STATUS REPORT**  
**Fiscal Year Ended June 30, 2013**

This section contains the current status of our prior audit recommendations. The recommendations are referenced to the pages of the management advisory report for the fiscal year ended June 30, 2012, dated December 12, 2012.

Recommendations	Status
<p><b>12-01 REVIEW PURCHASING AND PROCUREMENT PROCESS FOR INDEPENDENT CONTRACTORS</b>                      (page 4)</p> <p>The County should review its process for independent contractors to ensure that proper procurement procedures are adhered to. The County should also review its procedures for the issuance of these independent contracts to ensure compliance with the State and County procurement code.</p>	<p>Accomplished.</p>
<p><b>12-02 IMPROVE INTERNAL CONTROLS OVER THE PCARD PURCHASES</b>                      (page 5)</p> <p>The County should review its policies and procedures and strengthen internal controls over the use of the pCard. These policies and procedures could include mandatory training for all personnel handling pCard transactions at the various departments and agencies; continues monitoring of pCard transactions to ensure proper procurement procedures are followed; and implementation of violation reports and consequences for departments and agencies not following the established procedures.</p>	<p>Partially accomplished. The Purchasing division has issued a policies and procedures manual and has conducted training for individuals using the pCard. However, we noted several findings related to the purchasing process during the current year as noted on finding 13-01.</p>
<p><b>12-03 PROPERLY ACCOUNT FOR CONTINGENCIES</b> (page 6)</p> <p>The County should establish procedures to ensure that loss contingencies are properly accounted for and is timely communicated to the Accounting Division for proper accrual in the County's financial statements.</p>	<p>Accomplished.</p>

**County of Kaua'i, Hawai'i**  
**STATUS REPORT**  
**Fiscal Year Ended June 30, 2013**

Recommendations	Status
<p><b>11-01 REVIEW TREASURY TRUST ACCOUNTS</b> (page 8)</p> <p>The County should determine the proper disposition of the older balances held in the treasury trust accounts and implement procedures to require timely follow up with aging deposits. In addition, the County should review the use of the Planning Treasury Trust to ensure that the transactions recorded in the account are proper and determine who the balance in the account is being held for.</p>	<p>Partially accomplished. The Planning Treasury Trust has been reviewed and reconciled. However, the Public Works Fiscal Treasury Trust still includes older balances that should be reviewed. Refer to current year finding 13-02.</p>
<p><b>11-02 IMPROVE SEWER BILLING PROCESS</b> (page 8)</p> <p>The County should review the current process used for billing for the commercial sewer charges and determine whether it is feasible for the Department of Water to include the sewer charges in their billing process. This would help improvement the timeliness of the billings and reduce the potential for billing errors.</p>	<p>Accomplished.</p>

**CORRECTIVE ACTION PLAN**

**Bernard P. Carvalho, Jr.**  
Mayor



**Steven A. Hunt**  
Director of Finance

**Nadine K. Nakamura**  
Managing Director

**Sally A. Motta**  
Deputy Director of Finance

**DEPARTMENT OF FINANCE**

**County of Kauai, State of Hawaii**

4444 Rice Street, Suite 280, Lihu'e, Hawaii 96766  
TEL (808) 241-4200 FAX (808) 241-6529

December 12, 2013

Blake S. Isobe  
N & K CPAs, Inc.  
American Savings Bank Tower  
1001 Bishop Street, Suite 1700  
Honolulu, HI 96813-3696

Dear Mr. Isobe:

Attached are the County of Kauai's responses and corrective action plans related to your fiscal year 2013 audit report *Management Advisory Report's* Current Finding and Recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,

Steven A. Hunt  
Director of Finance

Attachment

*An Equal Opportunity Employer*

**Ref No. 13-01**

**IMPROVE INTERNAL CONTROLS OVER THE PCARD PURCHASES**

**Auditor's  
Recommendation:**

The County should strengthen internal controls over the use of the pCard. These include continuous monitoring of pCard transactions to ensure proper procurement procedures are followed; and implantation of violation reports and consequences for departments and agencies not following the established procedures.

**Management  
Response:**

We substantially agree with the findings and recommendations that have been issued by the auditor with regard to pCard purchases.

After the FY 12 audit and the subsequent findings of various procurement errors relating to pCard use in the County, a number of efforts were immediately undertaken in order to provide guidance and assistance to the various departments in order to assure compliance with the procurement code as in pertained to pCard use. These included:

1. Policy Memorandum 2013-5: Interim Guidance: pCards and other Commodities issued on January 25, 2013. The memorandum is posted on the Division of Purchasing (DoP) SharePoint portal and accessible to all County employees.
2. Completion and issuance of the pCard Policies and Procedures for General Commodities dated March 2013. This policy is posted on the DoP SharePoint portal.
3. Formal pCard training focusing on procurement requirements and responsibilities for small purchases. Participants: department heads, deputy department heads, fiscal officers, accountants, pCard holders, pCard approvers. The training occurred in June 2013. The power point training presentation has been placed on the DoP SharePoint portal for routine access by personnel involved in the use of the pCard.

## **IMPROVE INTERNAL CONTROLS OVER THE PCARD PURCHASES (Continued)**

These noted activities exercised needed due diligence to bring a better level of understanding, accountability, and compliance among employees involved in the use and approval of pCard purchases. While some problems remain, we understand that most of the current findings occurred prior to the formal pCard training that occurred in June 2013. We believe that the formal training that was provided has proven beneficial to the County and will show tangible results during the FY 14 audit in terms of a more comprehensive understanding of and compliance with the small purchase requirements as outlined in HRS 103D-305 as well as the associated administrative rules in Sub-Chapter 8.

It is also noteworthy that although the pCard findings were only reduced by one (14 in FY12 as compared with 13 in FY13), the number of cards issued has expanded greatly throughout our County departments as has the number of transactions. As a percentage of card holders and transaction count, there has been a proportionate improvement in the exercise of this payment method.

Other initiatives to be pursued in order to achieve future compliance:

1. The I.T. Division has developed an internal paperless process that is used by division personnel to document the proper procurement process and needed documentation of the goods and services being purchased. The process is automated in that approval of the request for procurement approval and use of the card is transmitted to the approving entity electronically. The I.T. Division has been asked to present this system County-wide so as to allow other departments to utilize this process.
2. The DoP will continue collective efforts with the I.T. Division to secure an interfaced pCard module that automates the documentation and approval processes similar to the purchase order system. This will eliminate the cumbersome paper-driven process that is currently in use by most departments and allow the pCard small purchase transactions to flow through our AS 400 system.

**IMPROVE INTERNAL CONTROLS OVER THE PCARD PURCHASES  
(Continued)**

3. Mandatory follow-up training will be provided by the Budget and Purchasing Director for all employees and their associated department heads and fiscal personnel who were identified as having committed procurement or procedural errors in this year's audit findings. In addition, all County personnel will once again be invited to participate in these repeat training sessions so as to increase their understanding and awareness of the procurement responsibilities and the required pCard policies and procedures.
4. The Director of Finance and Budget and Purchasing Director will coordinate training discussions specifically intended for department heads, deputy department heads, and pCard approvers to review the due process requirements involved in properly identifying and reporting procurement violations to the Division of Purchasing for proper investigation, findings, and disposition. These investigations are essential in order to identify the nature of the violation and issue corrective action in terms of discipline and additional training; to include the possibility of suspension of pCard use if the situation so justifies.

End Date: On-Going

Responding Person: Ernest Barreira, Budget and Purchasing Director  
Department of Finance  
Phone: 808-241-4295

**Ref No. 13-02                      REVIEW TREASURY TRUST ACCOUNTS**

**Auditor's Recommendation:**                      The County should determine the proper disposition of the older balances held in the treasury trust accounts and implement procedures to require timely follow up on aging deposits.

**Management Response:**                      Engineering Division will follow up on all old deposits. They will review all outstanding deposits every quarter thereafter.

**End Date:**    On-Going

**Responding Person:** James Matsushige, Business Management Officer  
Department of Public Works  
Phone: 808-241-4834

**Ref No. 13-03                      RECONCILE AND REVIEW RESIDENTIAL REFUSE COLLECTIONS ASSESSMENTS**

**Auditor's Recommendation:**                      The County should generate a report throughout the year that accounts for RRCA outstanding balances to allow personnel to monitor balances and reconcile outstanding balances that are recorded in the real property tax assessment system to the general ledger.

**Management Response:**                      Real Property separated the report to list only RRCA activity. Balances on the Real Property report and general ledger will be reconciled on a regular basis.

**End Date:**    On-Going

**Responding Person:** James Matsushige, Business Management Officer  
Department of Public Works  
Phone: 808-241-4834

**Ref No. 13-04**

**REVIEW UNEARNED REVENUES AND GRANT RECEIVABLES**

**Auditor's  
Recommendation:**

The County should investigate and determine the proper disposition of balances recorded in both grant funds receivable and unearned revenue in a timely manner to properly account for these grant balances.

**Management  
Response:**

A policy will be written outlining the steps that need to be taken by all County departments, to ensure that they monitor current receivables and unearned revenues (deferred revenues). Finance Administration will provide the departments with a list of their current outstanding receivables and deferred revenues, at least once a year, to provide a tool that can easily identify these items in our accounting system. Many of the older projects have been identified and departments have been taking measures to research the history of these open projects.

**End Date:**

On-Going

**Responding Person:**

Ann Marie K. Wooton, Budget Analyst  
Department of Finance  
Phone: 808-241-4213